

Message Text

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ACTION EB-07

INFO OCT-01 AF-06 ARA-06 EUR-12 NEA-10 ISO-00 FEA-01

ERDA-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00

FPC-01 H-02 INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01

PM-04 USIA-06 SAM-01 OES-03 SP-02 SS-15 STR-04

TRSE-00 PA-01 PRS-01 AGR-05 /121 W

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R 201005Z JAN 76

FM AMEMBASSY ISLAMABAD

TO SECSTATE WASHDC 3720

INFO AMEMBASSY KABUL

AMEMBASSY BELGRADE

AMEMBASSY BRASILIA

AMEMBASSY BUENOS AIRES

AMEMBASSY CAIRO

AMEMBASSY KINGSTON

AMEMBASSY KINSHASA

AMEMBASSY LIMA

AMEMBASSY LUSAKA

AMEMBASSY MEXICO

AMEMBASSY NEW DELHI

AMEMBASSY YAOUNDE

AMEMBASSY TEHRAN

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E.O. 11652: N/A

TAGS: EFIN, ENRG

SUBJECT: CIEC: IMPACT OF HIGHER OIL PRICES ON ECONOMIC DEVELOPMENT

REFERENCE: STATE 006381,

BEGIN SUMMARY: THIS IS IN RESPONSE TO REFTEL. HIGHER OIL PRICES
HAVE MULTIPLIED PAKISTAN'S OIL IMPORT BILL SEVEN FOLD IN THE
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PAST THREE YEARS, MAKING OIL PAKISTAN'S SINGLE LARGEST IMPORT

ITEM AND ACCOUNTING DIRECTLY OR INDIRECTLY FOR ABOUT ONE-THIRD OF THE PAKISTAN \$1.2 BILLION TRADE DEFICIT. THE BALANCE OF PAYMENTS IMPACT IS BY FAR THE MOST IMPORTANT ADVERSE EFFECT OF OIL PRICES ON THE PAKISTAN ECONOMY, AND THE ONE MOST LIKELY TO AFFECT THE ECONOMY IN THE FUTURE. OIL PRICES HAVE ALSO CONTRIBUTED TO INFLATION AND, THROUGH INCREASED WATER WELL PUMPING COSTS, HAMPERED THE AGRICULTURAL SECTOR. ONE THE OTHER HAND, THE SPECTACULAR INCREASE IN BFEC AID TO PAKISTAN (\$500 MILLION WAS DISBURSED IN FYHRQOUTL IS ALSO DUE TO THE INCREASE IN OIL PRICES. WE EXPECT THIS DISBURSEMENT LEVEL TO TAPER OFF IN FUTURE YEARS AS OPEC SURPLUSES FACE OTHER DEMANDS, /4?95# FOR OPEC COUNTRIES' DEVELOPMENT PLANS AND FOR OTHER WOULD-BE RECIPIENTS. THE PRESENCE OF OPEC AID NONETHELESS COLORS THE GOVERNMENT'S ATTITUDE TOWARD OIL PRICES, MAKING IT RELUCTANT TO SAY ANYTHING WHICH MIGHT BE OFFENSIVE TO THE OIL PRODUCING COUNTRIES. END SUMMARY

1. BY FAR THE MOST IMPORTANT ADVERSE EFFECT OF HIGHER OIL PRICES ON THE PAKISTAN ECONOMY HAS BEEN THE IMPACT ON THE BALANCE OF PAYMENTS. PREVIOUS REPORTING FROM ISLAMABAD (PRIMARILY 75 ISLAMABAD 9394 AND 11849, AND 74 ISLAMABAD 1874) HAS GIVEN STATISTICS ON BOTH A FISCAL AND CALENDAR YEAR BASIS FOR POL IMPORTS AND FOR OVERALL EXTERNAL TRADE. THE RECORD OF THE PAST FOUR YEARS, HOWEVER, IS WORTH REPEATING. THE FOLLOWING TABLE LISTS THE BASIC STATISTICS:

FY	POL	IMPORT BY (\$ MILLION)	POL/EXPORTS QUANTITY (L TONS)	POL/IMPORTS (VALUE)	POL/IMPORTS (VALUE)
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71-2	\$54	3,043,000	7 PERCENT	7.3 PERCENT	
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72-3	62	3,095,000	8 PERCENT	7.7 PERCENT	
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73-4	152	3,620,000	15 PERCENT	11.1 PERCENT	
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74-5	349	3,912,000	34 PERCENT	16.2 PERCENT	
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75-6	390-400	4,200,000	37-38 PERCENT	17.5 PERCENT	
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NOTE: IMPORT TONNAGE FIGURES APPROXIMATE. GOP HAS PUBLISHED SEVERAL SETS OF FIGURES.

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2. FOR PAKISTAN, PETROLEUM AND PETROLEUM PRODUCTS ARE NOW THE SINGLE LARGEST IMPORT ITEM AND CONSUME FOREIGN EXCHANGE EQUIVALENT TO ABOUT 37 PERCENT OF PAKISTAN'S EXPORTS. IN ADDITION, TWO IMPORTANT PETROCHEMICAL PRODUCTS - FERTILIZER AND INSECTICIDES, - WHOSE WORLD PRICES DOUBLED IN LARGE MEASURE BECAUSE OF POL PRICE INCREASES, ALSO ACCOUNT FOR A SUBSTANTIAL INCREASE IN THE IMPORT BILL. PAKISTAN'S TRADE WENT FROM NEAR

BALANCE IN FY 72 AND 73 TO A \$1.2 BILLION DEFICIT IN FY 75, WITH A SIMILAR ONE FORECAST FOR FY 76. HIGHER OIL PRICES DIRECTLY OR INDIRECTLY ACCOUNTED FOR ABOUT ONE-THIRD OF THIS DEFICIT. WITH IMPORTS MORE THAN DOUBLE EXPORT EARNINGS, WITH DEBT SERVICE ESCALATING, AND NO SUBSTANTIAL EXPORT BREAKTHROUGH IN SIGHT, MANAGING THE FOREIGN TRADE DEFICIT IS PROBABLY PAKISTAN'S SINGLE GREATEST SHORT AND MEDIUM-TERM ECONOMIC PROBLEM. THIS IS ALSO THE AREA WHERE THE STRONGEST EFFECTS OF THE OIL PRICE HIKE WILL BE FELT AFTER FY76.

3. ASIDE FROM THE BALANCE OF PAYMENTS, THE OIL PRICE INCREASES HAS CERTAINLY AFFECTED DOMESTIC INFLATION. GASOLINE AND KEROSENE PRICES HAVE RISEN 109 TO 200 PERCENT IN THE PAST TWO YEARS, AND THIS HAS CERTAINLY AFFECTED TRANSPORTATION AND OTHER DOMESTIC PRICES. THE OVERALL RATE OF INFLATION WAS ABOUT 30 PERCENT IN FY 1974, ABOUT 24 PERCENT IN FY 1975, AND IS LIKELY TO BE ABOUT 15 PERCENT THIS YEAR. THE COST OF RUNNING PAKISTAN'S WATER WELL PUMPS, A MAJOR INPUT INTO THE COUNTRY'S AGRICULTURAL ACTIVITY, HAS INCREASED SHARPLY.

4. THE LONGER RUN IMPACT IS MORE DIFFUSE BUT REAL. PAKISTAN HAS ONE OF THE LOWEST RATES OF PER CAPITA ELECTRICITY OUTPUT IN THE WORLD, AND DEMAND FOR POWER HAS BEEN GROWING AT A HIGH RATE. THE HIGH OIL PRICE HAS QUITE CLEARLY INFLUENCED PAKISTAN'S THINKING ABOUT FUTURE POWER DEVELOPMENT, AND HAS MADE GOP THINKERS MORE INCLINED THAN PREVIOUSLY TO CONSIDER NUCLEAR POWER AS A MAJOR FUTURE SOURCE OF ELECTRICITY. THE HIGH PRICE OF OIL WILL DIRECTLY OR INDIRECTLY LIMITED OFFICIAL USE

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RESULT IN A SUBSTANTIAL INCREASE IN THE COST TO PAKISTAN OF EXPANDING POWER GENERATION. OTHER INDUSTRIAL PLANS HAVE NOT BEEN DIRECTLY ADVERSELY AFFECTED BY OIL PRICE. IN THE CASE OF THE FERTILIZER INDUSTRY, ONE OF PAKISTAN'S HIGHEST PRIORITY SECTORS FOR INVESTMENT IN THE NEXT TWO OR THREE YEARS, THE AVAILABILITY OF NATURAL GAS TO USE AS FEEDSTOCK FOR THE PROJECTED PLANTS HAS BEEN A VERY IMPORTANT CONSIDERATION. BECAUSE OF THE LOW BTU AND HIGH AMMONIA CONTENT OF PAKISTAN'S KNOWN GAS RESERVES, THE INCREASED VALUE OF GAS AS FUEL HAS NOT CHANGED THE PRIORITY OF THESE PLANS. THE FOREIGN EXCHANGE COST OF THE MALARIA CONTROL PROGRAM WHOSE IMPLEMENTATION IS NOW STARTING IS NOW ESTIMATED TO HAVE INCREASED FROM THE ORIGINAL PLANNING FIGURE OF \$62.3 MILLION TO \$100 MILLION IN FY 76-80.

5. AS SUGGESTED IN PARA 3 OF REFTTEL, THE GENERAL
INCREASE IN IMPORT PRICES, INCLUDING THE OIL PRICE
HIKE, AND THE RECESSION IN THE INDUSTRIALIZED

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INFO OCT-01 AF-06 ARA-06 EUR-12 NEA-10 ISO-00 FEA-01

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COUNTRIES HAVE TAKEN THEIR TOLL ON THE PAKISTAN
ECONOMY. WE ESTIMATE THAT MOST OF THE \$40 MILLION
DROP IN COTTON EXPORT EARNINGS BETWEEN FY 73 AND 75
WAS THE RESULT OF THE RECESSION IN THE WEST. ON THE

IMPORT SIDE, OUR ANALYSIS SUGGESTS THAT POL PRICES
HAVE INCREASED FASTER AND HELD THE HIGHER LEVEL MORE
FIRMLY THAN PAKISTAN'S OTHER IMPORT PRICES. OUR
INITIAL ANALYSIS ALSO SUGGESTS THAT THE RISE IN OIL
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PRICES HAS FORCED PAKISTAN TO CUT BACK ON IMPORTS OF
MANUFACTURES, INCLUDING IN MANY CASES IMPORTS IMPORTANT
TO PAKISTAN'S DEVELOPMENT PROGRAM.

6. IN ADDITION TO REDUCING DEMAND FOR PAKISTAN'S
EXPORTS, THE RECESSION IN THE DEVELOPED COUNTRIES
ADVERSELY AFFECTED PRODUCTION IN THE TEXTILE SECTOR
OF PAKISTAN, BY FAR THE LARGEST INDUSTRIAL SECTOR
AND A MAJOR CONTRIBUTOR TO PAKISTAN'S EXPORT EARNINGS.
THIS WAS AN IMPORTANT CONTRIBUTING FACTOR IN THE
DISAPPOINTINGLY LOW GROWTH RATE PAKISTAN ACHIEVED
DURING FY 1975 (3 PERCENT IN REAL TERMS).

7. ONE THE OTHER SIDE OF THE LEDGER, PAKISTAN HAS
BEGUN RECEIVING SUBSTANTIAL AMOUNTS OF AID FROM THE
OPEC COUNTRIES SINCE THE OIL PRICE INCREASE.
INFORMATION AVAILABLE IN ISLAMABAD SUGGEST THAT
PAKISTAN IS BY FAR THE LARGEST NON-ARAB RECIPIENT OF
OPEC AID, RECEIVING EVEN MORE THAN MOST ARAB COUNTRIES.
OPEC COUNTRIES PROVIDED \$500 MILLION IN AID DISBURSEMENTS
IN FY 1975, COVERING NEARLY HALF OF PAKISTAN'S TRADE
GAP AND ACCOUNTING FOR HALF OF TOTAL AID DISBURSEMENTS.
WHILE THIS YEAR'S PERFORMANCE IS UNLIKELY TO BE AS
HIGH, THE OPEC COUNTRIES WILL AT LEAST FOR THE NEXT FEW
YEARS BE A MAJOR SOURCE OF AID FOR PAKISTAN. (FOR
OPEC AID ON A CALENDAR YEAR BASIS, SEE 75 ISLAMABAD 11849.)

8. IT IS CLEAR TO US THAT THE GOVERNMENT IS VERY WELL
AWARE OF THE SEVERE IMPACT OF OIL PRICE INCREASES ON
PAKISTAN'S BALANCE OF PAYMENTS. PUBLIC PERCEPTIONS
OF THE EFFECT OF THE OIL PRICE INCREASES ARE ANOTHER
MATTER. FOR REASONS OF BOTH POLITICS AND AID FLOWS -
THE GOP IS EAGER TO PRESERVE GOOD TIEU WITH THE MUSLIM
COUNTRIES AND RELUCTANT TO OFFEND THESE NEW MAJOR
AID DONORS. DISCUSSION OF THE IMPACT OF OIL PRICES
ON PAKISTAN FOREIGN TRADE ONLY APPEAR IN THE CONTROLLED
PRESS IN VERY MUTED TONES. MOST DISCUSSIONS OF THIS
SUBJECT, AND MANY PUBLIC STATEMENTS BY GOP OFFICIALS,
BEGIN AND END BY REFERRING TO THE ALLEGEDLY MUCH
GREATER IMPACT ON PAKISTAN OF INCREASES IN PRICE
OF MANUFACTURED GOODS FROM THE DEVELOPED COUNTRIES.
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VIRTUALLY ALL PUBLIC DISCUSSIONS OF THE OIL PRICE
REFER TO OPEC COUNTRIES GETTING "THE RETURN THEY
DESERVE" ON OIL. THE NEWSPAPER READING PUBLIC IS
AWARE OF THE SUBSTANTIAL JUMP IN THE OIL IMPORT BILL,
AND ONE DOES HEAR PRIVATE CRITICISM OF THE HIGH OIL
PRICES. BUT GOP HANDLING OF THIS SUBJECT DOES NOT
ENCOURAGE THE PUBLIC TO THINK OF OIL PRICES AS A
MAJOR SOURCE OF PAKISTAN'S ECONOMIC TROUBLES.
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